

General Information Letter: Schedule K-1-T is used to report allocation and apportionment information, addition and subtraction modifications, and credit information to beneficiaries.

November 22, 2002

Dear:

This is in response to your letter dated November 18, 2002, in which you request advice. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

In your letter you have stated the following:

I would appreciate it if you would advise the proper way to complete Form K-1-T in a most common situation where there is no federal taxable income because it is the final year and all income has been distributed or it is a year other than the final year and there have been distributions to beneficiaries in excess of income. In each of these instances, the federal return will show zero income and the State of Illinois Form 1041 will, on Line 1, show zero income. This is on the assumption that there was no federally tax exempt interest income or any Illinois income and replacement tax that was deducted or any other additions to income shown on the federal return. We would also assume there was no Illinois business income.

The instructions for the K-1-T state that it must be completed and sent to any beneficiary if any part of the income is paid, credit or distributed to that beneficiary.

The Schedule K-1-T(2) Beneficiary Instructions state that if the beneficiary is a resident of Illinois, all amounts in column A must be included as income and modifications allocated to Illinois. The instructions for lines 9 through 29 state that the beneficiary should make sure the amounts reported on these lines are as included in their federal return.

It would appear to me that the completion of K-1-T and the instructions to the beneficiaries would result in a double reporting of income by the beneficiary. The beneficiary is required to include this income on his or her individual federal return because it is on his federal 1041 K-1. Therefore the income would have been included on line 1 of the individual's IL-1040 because it was carried over from the federal 1041 and then would be included again if the instructions were literally followed. I am sure this is not the intent of the instructions.

I would, therefore, request that you advise how this problem should or could be avoided or if I have misread the instructions what my misinterpretation consists of. I by chance I am correct in my analysis, I would suggest that the Illinois Department of Revenue consider revising its rules to provide that the K-1-T be completed only if the beneficiary has income taxable in Illinois unless there is some reason of which I am unaware that

would require reporting to the beneficiary income that is not separately taxed on their individual return.

### **Response**

The purpose of the Schedule K-1-T is to enable the beneficiary of a trust or estate to comply with the provisions of Sections 306 and 307 of the Illinois Income Tax Act (35 ILCS 5/306 and 5/307). Section 306 of the Illinois Income Tax Act provides:

The items of income and deduction taken into account by an estate or trust in computing its base income for a taxable year shall be allocated or apportioned to this State to the extent provided by Sections 301 through 304 and, to the extent properly paid, credited or required to be distributed to beneficiaries for such taxable year, shall be deemed to have been so paid, credited or distributed pro rata.

In other words, in your situations where the trust has distributed all of its income, every item of income and deduction taken into account in computing federal taxable income of the trust, and all Illinois addition and subtraction modifications allowed to the trust, are passed through to the beneficiaries and treated by them as if the beneficiaries had received or incurred them directly. This follows the federal income tax treatment, where the Schedule K-1 instructs the individual beneficiary to report the items of income and deduction shown on the Schedule K-1 in the same manner as items received or incurred directly by the beneficiary.

Section 307 of the Illinois Income Tax Act provides:

(a) Allocation of business income by beneficiaries other than residents. To the extent the business income of an estate or trust allocated or apportioned to this State in the possession of the estate or trust is deemed to have been paid, credited or distributed by the estate or trust under Section 306, the respective shares of beneficiaries of the estate or trust, other than residents, in such business income shall be taken into account by such beneficiaries in proportion to their respective shares of the distributable net income of the estate or trust for its taxable year and allocated to this State.

(b) Allocation of nonbusiness income by beneficiaries other than residents. To the extent items of estate or trust income and deduction not taken into account in computing the business income of an estate or trust are deemed to have been paid, credited or distributed by the estate or trust under Section 306, the respective shares of beneficiaries of the estate or trust, other than residents, in such items shall be taken into account by such beneficiaries in proportion to their respective shares of the distributable net income of the estate or trust for its taxable year, and allocated as if such items had been paid, incurred or accrued directly to such beneficiaries in their separate capacities.

(c) Accumulation and capital gain distributions. In the event that, in any taxable year of a trust, the trust makes an accumulation distribution or a capital gain

distribution (both as defined in Section 665 of the Internal Revenue Code), the total of the amounts which are included in the income of each beneficiary of such trust, other than a resident, under Sections 668 and 669 of the Internal Revenue Code shall be allocated to this State to the extent that the items of income included in such distribution were allocated or apportioned to this State in the hands of the trust.

The Schedule K-1-T has two main purposes under these provisions. First, it is used to report all Illinois addition and subtraction modifications to all beneficiaries so that the beneficiaries may properly take them into account on their Illinois returns. Second, it is used to instruct nonresident beneficiaries on the allocation and apportionment of all items included in their base income, both items included in their federal taxable income or adjusted gross income and addition and subtraction modifications.

In order to accomplish this latter goal, it is necessary for the Schedule K-1-T to divide the various items of income, deduction, addition and subtraction into the different categories of business and nonbusiness income that have different rules for allocation and apportionment. In order to make sure that all items are properly reported to the beneficiary, it was necessary to insure that these categories tie in to the amounts reported on the federal Schedule K-1. Accordingly, the line items on the Schedule K-1-T for amounts included in federal taxable income or adjusted gross income are designed to bridge between the federal Schedule K-1 line items and those on the Form IL-1041 Schedule NR.

In the Schedule K-1-T(2), the beneficiary's instructions for Column A, lines 9 through 29, of the Schedule K-1-T merely state, "Make sure the amounts reported on these lines are as included on your federal return." Nowhere do the instructions say to add these amounts a second time on the Illinois return. This is merely to enable the beneficiary to insure that all amounts passed through by the trust are properly taken into account.

In contrast, the instructions for the addition and subtraction modifications in Column A of lines 30 through 37e tell the beneficiary where to enter those amounts on the Illinois return. In addition, the instructions for Column B for all items tell the nonresident beneficiary where to report those amounts in the allocation and apportionment sections of their returns.

In the case you describe, where there are no addition or subtraction modifications and no business income, the Schedule K-1-T would still be used to inform the beneficiaries that there are no modifications and the schedule would still be needed to instruct nonresident beneficiaries how to properly allocate the nonbusiness income items reported on lines 9 through 18, which are included in their federal taxable income or adjusted gross income.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

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Sincerely,

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